



6-1-1981

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Recommended Citation

Stanley A. Kaplan, *Some Ruminations on the Role of Counsel for a Corporation*, 56 Notre Dame L. Rev. 873 (1981).

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Some Ruminations on the Role of Counsel for a Corporation

Stanley A. Kaplan*

I. Introduction

There has been a great spate of discussion during the last several years concerning various aspects of the conduct and responsibilities of counsel for a corporation.¹ Among the matters receiving extensive consideration are: (1) the confidentiality of information held by or opinions given by counsel to the corporation—an issue the Supreme Court of the United States recently addressed in *Upjohn Co. v. United States*;² (2) the corporate lawyer's possible obligation, asserted in the complaint of the Securities and Exchange Commission (SEC) in the *Carter-Johnson*³ rule 2(e)⁴ proceedings, to report certain information over the head of the corporation's chief executive officer (CEO) to the board of directors; (3) the corporate lawyer's possible obligation, asserted by the SEC in the *National Student Marketing*⁵ litigation, to "blow the whistle" or report to the relevant public regulatory authority if the corporation engages in illegal action; and (4) the determination of who is the lawyer's client as set forth in Ethical Consideration (EC) 5-18 of the American Bar Association (ABA) Code of Professional Responsibility (the Code) and its counterpart in the proposed Model Rules of Professional Conduct (the Model Rules).⁶

This article will focus upon the relationship between a corporation and a law firm which is the corporation's general counsel. It should be recognized that such a relationship may differ from the relationship existing between a corporation and the following kinds of counsel: a law firm which is special counsel to the corporation for a particular area of business law (for example, antitrust counsel); a law firm which is handling an isolated, discrete matter for the corporation; a general counsel who is also an employee of the corporation;⁷ a law firm engaged by in-house general counsel to prepare a research memorandum; and various

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1 See, e.g., Taylor, *The Role of Corporate Counsel*, 32 RUTGERS L. REV. 237 (1979); Proceedings, ABA National Institute, *Advisors to Management, Responsibilities and Liabilities of Lawyers and Accountants*, 30 BUS. LAW. 1 (Spec. Issue, Mar. 1975); Frank, *Higher Duty: A New Look at the Ethics of the Corporate Lawyer*, 26 CLEV. ST. L. REV. 337 (1977); Panel Discussion, *The Murky Divide: Professionalism and Professional Responsibility, Business Judgment and Legal Advice—What Is a Business Lawyer?*, 31 BUS. LAW. 457 (1975); Ferren, *The Corporate Lawyer's Obligation to the Public Interest*, 33 BUS. LAW. 1253 (1978).

2 101 S. Ct. 677 (1981).

3 *In re Carter & Johnson*, [1981 Current Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 (Feb. 28, 1981).

4 Rule 2(e) of the SEC Rules of Practice, 17 C.F.R. § 201.2(e) (1980).

5 SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978).

6 Discussion Draft of the ABA Model Rules of Professional Conduct proposed by the Commission on Evaluation of Professional Standards, ABA MODEL RULES OF PROFESSIONAL CONDUCT (Discussion Draft, Jan. 30, 1980) [hereinafter referred to as MODEL RULES].

7 There has been very little academic or judicial discussion of the role of a corporation's in-house general counsel and of the special characteristics of that role, although there must be much soul-searching among lawyers who perform that role. *But see* Davis, *Reflections of a Kept Lawyer*, 53 A.B.A. J. 349 (1967);

others kinds of arrangements. It will be assumed that the corporation's relationship to its outside lawyer is the same regardless of whether the lawyer is an individual practitioner, a law firm, or an individual lawyer within a law firm.

In order to crystallize various ideas concerning the nature of the role of counsel to⁸ the corporation, it may be helpful to set forth a series of questions, consideration of which might produce a clearer portrait of the lawyer's role. Many of these questions do not as yet have fully developed answers, and it will be impossible to grapple with them all in this short piece. Nonetheless, the following questions are among those worth pondering:⁹

(1) Is counsel for a corporation in a different lawyer-client relationship than counsel who represents an individual client?

(2) Does counsel for the corporation represent, in addition to the corporation, any of those who act for or are constituent parts of the corporation—for example, the board of directors, the CEO, or any group of shareholders?

(3) If counsel for the corporation represents any such persons in addition to the corporate entity, under what circumstances, if any, does such dual representation not create an impermissible conflict of interest?

(4) Who hires counsel for the corporation—the CEO, the board of directors, or the shareholders?

(5) To whom should counsel for the corporation deliver legal opinions? Who has the right to hear or see those opinions?

(6) If an officer or employee of the corporation refuses to follow counsel's advice or delays in following that advice for an inordinate length of time, under what circumstances, if any, does counsel have an obligation to report such fact to a higher authority within the corporation?

(7) If the corporation has committed, or is about to commit, an illegal act of which counsel is apprised, must counsel report such fact to the public authorities?

(8) Must the corporation's board of directors require counsel for the corporation to report periodically to the board concerning the status of legal matters affecting the corporation? Should counsel for the corporation have an institutionalized opportunity to appear before the board or one of its committees from time to time to discuss those matters?

(9) What is the proper role of counsel attending a board meeting? To what extent does counsel have the right or obligation to correct or amplify statements made to the board by directors or officers?

(10) What roles should counsel for the corporation play in connection with business (as opposed to legal) judgments?

II. The Nature of the Problem

Although the board of directors is the corporation's primary and highest authority,¹⁰ the relationship between the corporation's board and its counsel has

Ferrara & Steinberg, *The Role of Inside Counsel in the Corporate Accountability Process*, 4 CORP. L. REV. 3 (1980); Rust, *What the Chief Executive Looks For in His Corporate Law Department*, 33 BUS. LAW. 811 (1978).

⁸ There does not even seem to be uniformity regarding whether to refer to counsel as "to" a corporation or "for" a corporation.

⁹ Many other significant questions could, of course, be added to this list.

¹⁰ See, e.g., MODEL BUSINESS CORPORATION ACT § 35 (1977).

always been ambiguous. No one doubts that counsel's loyalty is owed to the corporation; in that sense it is owed primarily to the board of directors rather than to the CEO because of the board's primacy within the corporation. Even if the board delegates to the CEO its function of dealing with the general counsel, the very fact that delegation has occurred implies that the board may revoke such delegation and deal directly with counsel if it so chooses. Even in states adopting the newly-revised version of section 35 of the Model Business Corporation Act,¹¹ which states that the corporation's affairs shall be managed under the direction of (rather than by) the board of directors, the same relationship between the corporation's board and its general counsel should prevail.

In its Report of Investigation *in re* National Telephone Co.,¹² the SEC stated:

In general, outside directors should be expected to maintain a general familiarity with their company's communications with the public

Moreover, as here, when important events central to the survival of the company are involved, directors have a responsibility affirmatively to keep themselves informed of developments within the company and to seek out the nature of corporate disclosures to determine if adequate disclosures are being made.¹³

The extent of directors' obligation to inquire into the company's operations has not been adequately delineated.¹⁴ However, it would seem almost impossible for directors to perform competently without making the arrangements necessary to permit them to keep abreast of the company's affairs. Since an important part of the company's affairs is its legal situation, it would seem appropriate for the directors to inquire periodically into such legal situation.

The relationship between a corporation's board and its counsel presumably entitles the board to call upon counsel for information and consultation. Conversely, has counsel any obligation to turn to the board for guidance, or to inform the board where legal action or the delivery of legal information to the board appears appropriate or necessary? The circumstances which trigger counsel's responsibility to impart information to the board, and the mechanics of any such communication, are matters which are presently ill-defined.

The statement that the board is the corporation's paramount authority is, of course, somewhat inaccurate, since the corporation's shareholders have even greater power than the board in some respects. It might be argued by analogy that the role of counsel for the corporation gives rise to a direct relationship between shareholders and counsel. Beginning with the landmark case of *Garner v. Wolfinbarger*,¹⁵ the courts have granted shareholders in derivative actions the right to see letters of advice from counsel for the corporation to the CEO, at least in connection with derivative actions asserting wrongdoing on the part of officers

¹¹ *Id.*

¹² Securities Exchange Act of 1934, Release No. 14,380, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,410.

¹³ *Id.* at 88, 880.

¹⁴ See generally Small, *The Evolving Role of the Director in Corporate Governance*, 10 HASTINGS L. J. 1353 (1979); Hershman, *Liabilities and Responsibilities of Corporate Officers and Directors*, 33 BUS. LAW. 263 (1977); Chaplin, *Outside Directors and Their Responsibilities: A Program for the Exercise of Due Care*, 1 J. CORP. L. 57 (1975); *Corporate Director's Guidebook*, 33 BUS. LAW. 1591 (1978).

¹⁵ 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

and directors.¹⁶ Whether courts would or should go so far as to require counsel to answer questions, without restriction, at a general meeting of shareholders is highly doubtful.¹⁷ A shareholders' meeting is in reality a public forum, open to the entire communications media. It might be disadvantageous or even disastrous for a corporation to have sensitive legal matters (for example, the status of lawsuits against the corporation) prematurely disclosed to shareholders and, through them, to the public. Thus, the courts will likely deny shareholders such unrestricted access to counsel for the corporation.

The primary professional relationship of the lawyer for the corporation is usually with the CEO or some other executive officer designated by the CEO. A close working (and sometimes personal) relationship often develops between the lawyer and the executive. This close relationship makes it difficult for the lawyer to determine how to comport himself if, for example, the executive with whom he is dealing rejects his advice and countenances an illegal action, or refuses to follow the lawyer's recommendation to institute a program to avoid future legal difficulties, or withholds information about illegal corporate conduct from the board of directors. The lawyer also faces difficulties when conducting an investigation on behalf of the corporation on a matter in which the corporation's interests diverge from or are adverse to those of the executive. All of these situations can be extremely awkward, particularly if the lawyer's obligation requires him to take a position in conflict with the executive's interests. Suppose, for example, that the lawyer advises the CEO that he is required by law to take a particular course of action and the CEO either refuses to do so or merely refrains from doing so. Any attempt by the lawyer to overturn the CEO's position—for example, by notifying the board of directors in writing of the CEO's recalcitrance, by attempting to call a special meeting of the board, or by speaking out at a regular board meeting—would be an extraordinary action, justified only under highly unusual circumstances of major significance to the corporation. It would almost certainly be regarded by the CEO as a hostile act, and would probably destroy any possibility of a harmonious and effective future working relationship.

III. The ABA Code of Professional Responsibility and the Proposed Model Rules

The present ABA Code of Professional Responsibility touches upon the problem proposed above only tangentially, under the rubric of conflict of interest. After a general adjuration against lawyers acting for clients where there is a conflict of interest,¹⁸ EC 5-18 states:

A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep

¹⁶ See, e.g., *Valente v. Pepsico*, 68 F.R.D. 361 (D. Del. 1975); *Bailely v. Meister Brau, Inc.*, 55 F.R.D. 211 (N.D. Ill. 1972).

¹⁷ The United States District Court for the Northern District of Texas recently ruled that disclosure documents prepared by a law firm in anticipation of securities fraud litigation against its corporate client are not available to shareholders suing derivatively. The judge also refused to allow the shareholders to depose a special officer appointed to investigate the company's accounting and auditing practices in a settlement of an SEC enforcement action brought against the company. *In re LTV Securities Litigation*, reported in SEC. REG. & L. REP., Apr. 8, 1981, at A-7 (N.D. Tex., Mar. 23, 1981).

¹⁸ ABA CODE OF PROFESSIONAL RESPONSIBILITY, EC 5-14 (1977).

paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization.¹⁹

This statement is neither a disciplinary rule nor a mandated course of conduct; it sets forth only an aspirational goal. The guidance that can fairly be derived from EC 5-18 with respect to the present problem is the general principle that counsel for a corporation cannot properly act for anyone else to the corporation's detriment. Beyond that threshold pronouncement EC 5-18 provides no enlightenment: It neither deals with the problem realistically nor gives counsel the concrete guidance he needs.

The proposed Model Rules attempt to deal with this situation by means of a rule which, at least in its initial form, strongly suggested the position espoused in the SEC's complaint in *Carter-Johnson*. Model Rule 1.13²⁰ grapples directly with numerous aspects of the problem under discussion. The rule's premise is that the lawyer who acquiesces in the illegal conduct of the corporation's CEO is not serving the corporation's best interest. The CEO is, within proper boundaries, the executive in charge of running the enterprise. The corporation's lawyer cannot place himself in a position of second-guessing or overruling the CEO's judg-

¹⁹ *Id.*, EC 5-18.

²⁰ In its most recent form (dated Feb. 6, 1981) the proposed rule states:

(a) A lawyer employed or retained to represent an organization represents the organization as distinct from its directors, officers, employees, members, shareholders, or other constituents.

(b) If a lawyer for an organization knows that an officer, employee, or other person associated with the organization is engaged in or intends actions, or a refusal to act, that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in significant injury to the organization, the lawyer *shall* use reasonable efforts to prevent the injury. In determining the appropriate measures, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations. The measures taken shall be designed to minimize disruption and the risk of a disclosure of information gained in or relating to the representation of the organization. Such measure may include:

- (1) Asking reconsideration of the matter;
- (2) Advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
- (3) Referring the matter to higher authority in the organization, including, if necessary, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(c) When a matter has been referred to the organization's highest authority in accordance with paragraph (b), and that authority insists upon action, or a refusal to act, that is clearly a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer *may* take further remedial action that the lawyer reasonably believes to be in the best interest of the organization. Such action may include disclosure of information gained in or relating to the representation of the organization if the lawyer reasonably believes that:

- (1) The highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in conflict with the interests of the organization; and

- (2) Disclosure of the information is necessary in the best interest of the organization.

(d) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of rule 1.7. If the organization's consent to the dual representation is required by rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented.

(e) In dealing with an organization's officials and employees, a lawyer shall explain the identity of the client when necessary to avoid embarrassment or unfairness to them. (Emphasis added.)

ments—except in the rarest of instances. If the CEO is the board's agent and seeks to take an action which is beyond his authority as enunciated in the by-laws or in board resolutions, his orders are null and without force.²¹ On the other hand, if his judgments, however wrong, are within the powers entrusted to him, they are not subject to the censorial power of the corporation's lawyer. The lawyer is neither a super-executive endowed with infallible judgment on business matters nor a roving surrogate of the board.

To digress, but only temporarily, let us postulate a situation in which the lawyer dealing with the CEO believes that the CEO is making a preposterously bad business decision, but one well within the area of judgment properly entrusted to the CEO. Does the lawyer have any obligation either to argue the business judgment question with the CEO or to bring to the board's attention the detrimental character of that judgment? One could argue, in a manner not too different from the approach of Model Rule 1.13, that an egregiously bad business judgment portends an injury to the corporation which the lawyer as corporate fiduciary is obligated to prevent, just as he would be expected to call the police if he saw a burglary about to take place in the company's plant. The lawyer must walk a very straight path: On the one hand, he must avoid being perceived within the corporate hierarchy as an officious tale-telling intermeddler; on the other hand, he must avoid becoming a passive but nonetheless culpable accomplice in an impropriety or illegality being perpetrated by one of the corporate executives. Fear of being drawn into the participant category will often force the lawyer to raise questions about doubtful conduct and to report such conduct to any superior authority. One may question whether it is better to make such reporting mandatory or to leave the reporting decision to the judgment of the lawyer, with the hope that he will exercise that judgment sensibly and well.

IV. The *Carter-Johnson* Decision

The Securities and Exchange Commission recently handed down its long-awaited decision in *Carter-Johnson*,²² an administrative proceeding under rule 2(e)²³ to disbar two prominent New York securities lawyers from practicing before the SEC. The primary issue in the case was whether outside lawyers for a corporation, whose legal advice to the CEO to make certain public disclosures had not been followed for a lengthy period of time, had an obligation to report this fact to the corporation's board of directors.

National Telephone Company, Inc. engaged attorneys Carter and Johnson to act as securities counsel in certain matters. The company was engaged in a highly leveraged equipment leasing business which went bankrupt after efforts to

²¹ See generally N. LATTIN, *THE LAW OF CORPORATIONS* (2d ed. 1971), at 218-38.

²² *In re Carter & Johnson*, [1981 Current Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 (Feb. 28, 1981). Candor requires the author to disclose that he participated in that case as an expert witness for the respondents.

²³ Rule 2(e)(1) of the SEC Rules of Practice provides:

The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to a person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws . . . , or the rules and regulations thereunder.

shore up its shaky financial structure proved unsuccessful. The lawyers were charged with aiding and abetting a violation of rule 10b-5²⁴ in connection with an SEC filing on form 8-K, with approving a misleading letter which the company had disseminated, and with unprofessional conduct. In an eighty-three page opinion, the Commission reversed the finding of the administrative judge and dismissed the charges.

The aspect of the *Carter-Johnson* litigation most relevant to the present discussion stemmed from the charge in the SEC complaint that the lawyers were derelict, and therefore subject to discipline, for failing to inform the corporation's board of directors that the advice the lawyers had given the CEO had not been followed. The lawyers had advised the CEO to announce publicly the activation of a certain financing plan which was to be put into effect if the company's financial status dropped to a stipulated level.²⁵ The CEO failed to make such an announcement for four weeks (and arguably nine weeks) despite being urged on several occasions to do so by Carter and Johnson. The SEC's complaint made no allegation that the lawyers' advice was in error; it urged that the lawyers be disciplined for failing to take their advice over the head of the CEO to the board.²⁶

The Commission began its lengthy opinion by upholding its own power to promulgate rule 2(e) and to discipline lawyers appearing before it;²⁷ that power had been challenged in a number of instances and its existence had even been denied by former Commissioner Roberta Karmel in a dissent in one of the Commission's earlier opinions.²⁸ After a detailed discussion of the facts of the case, the Commission absolved Carter and Johnson of the charge of violating or helping the company to violate rule 10b-5. The Commission held that Carter and Johnson were neither participants in the violation of the law nor aiders or abettors. The Commission stated that a person could not be liable as an aider or abettor unless he had knowledge that the principal violator was perpetrating a wrong.²⁹

The Commission then turned, in a very brief and general discussion—which appeared casual but which was probably very studied—to the question of the lawyers' responsibility to report to the board their belief that the CEO was causing the company to commit an illegal act. The Commission dismissed the count against the lawyers based upon their failure to make such a report, largely because it found the law and the rules of professional responsibility on this subject

24 17 C.F.R. § 240.10b-5 (1980).

25 [1981 Current Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 at 84,157-59.

26 *Id.* at 84,165.

27 *Id.* at 84,149.

28 See the dissenting opinion of Commissioner Karmel in *In re Keating, Muething and Klekamp*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,124 (July 2, 1979) (Exchange Act Release No. 15982). See generally *Marsh, Rule 2(e) Proceedings*, 35 BUS. LAW. 987 (1980) and Letter of the Federal Regulation of Securities Committee, ABA Section of Corporate, Banking and Business Law (June 19, 1974) (file no. S7-520). See also *Touche Ross & Co. v. SEC*, 509 F.2d 570 (2d Cir. 1979), dealing with the SEC's power with respect to accountants; Bialkin, *Commission's Latest 2(e) Proceeding Profoundly Disquiets Securities Bar*, Nat'l L.J., Apr. 30, 1979; Bialkin, *SEC Clears Air Concerning Lawyers' Disclosure Duties*, N.Y.L.J., Mar. 17, 1981; Klein, *SEC Hands Securities Bar "Candy-Coated Bitter Pill"*, Legal Times of Wash., Mar. 9, 1981.

29 [1981 Current Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 at 84,172. Commissioner Evans dissented from the Commission's holding on the aider and abettor point.

After the opinion was rendered, the staff sought reconsideration of the aider and abettor point. Specifically, it sought modification of the opinion's language concerning the scienter required of the person against whom liability as a secondary violator was being asserted.

to be so vague and inchoate that it would be unfair to punish these lawyers, who had made a good faith effort to deal with an intractable client.³⁰

The position of the corporate lawyers in the wake of *Carter-Johnson* is nebulous at best. The decision leaves the lawyer here, like the director in a *BarChris*³¹ situation, with a clear obligation to do something but with scant guidance as to what it is he must do or how he must do it. Although the Commission seemed sensitive to lawyers' predicament, it studiously refrained from giving useful instruction. Lawyers practicing in the field consequently may find themselves being judged by hazy and unannounced standards which require them to act aggressively. Unlike attorneys Carter and Johnson, they will be unable to claim that the Commission had not warned them of the need for action by lawyers.

The problem corporate lawyers face is compounded by the ambiguous, all-embracing statement of legal theories filed in *Carter-Johnson* by the SEC Office of the General Counsel, setting forth the source of the standards of professional conduct upon which the staff believes the Commission may draw.³² The Commission in its decision did not even comment upon this statement of legal theories, but it will surely be available to staff members in the future and is susceptible of being incorporated into the process of determining the standards eventually enforced by the Commission. The statement of legal theories sets forth the following as a source of the standards to which lawyers must conform:

In analyzing an attorney's conduct, it is appropriate, and useful, to look to the American Bar Association Code of Professional Responsibility, as well as the Canons of Professional Ethics and ethical codes adopted by the various state bars. Nevertheless, although the Commission may look to the bar's official or unofficial interpretations of these codes, it is not bound by such interpretations; rather, it has the right to construe and interpret these standards as they apply to practice before the Commission.

Moreover, these codes are not the exclusive standards against which the conduct of attorneys practicing before the Commission should be measured, even assuming that no violation of the law occurred. Ethical codes embody standards, but do not purport to be exhaustive. An attorney practicing before the Commission may be subject to sanction upon a conclusion that he engaged in the conduct described by paragraph 43(b) where the Commission perceives that the attorney's conduct was such that its own process would be impaired if that attorney were permitted to continue to represent others before the Commission.

Attorneys are fiduciaries and "guardians of the law"; thus, they are governed by all of the developing concepts of fiduciary law, including without limitation, the responsibilities of counsel with respect to publicly-held corporations they represent. The Commission, with the right to construe and interpret, should look to all of the concepts, as well as the prescriptions, of this body of knowledge and its own precedents under Rule 2(e) to determine if an attorney has engaged in conduct within the ambit of paragraph 43(b).³³

The Commission in *Carter-Johnson* recognized that it has never adopted or

30 *Id.* at 84,173. The Commission did not pass upon or even comment upon counsel's obligation to blow the whistle or make a report to the public authorities, stating that the issue was not before it.

31 *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968).

32 Statement of Legal Theories Underlying ¶ 43(b) of the Order for Proceedings in the Matter of William R. Carter and Charles J. Johnson, Jr. Before the Securities and Exchange Commission (July 24, 1978).

33 *Id.* at 3-5 (footnotes omitted).

endorsed "standards of professional conduct" applicable to the activities of Carter and Johnson, but then asserted its authority to adopt such standards:

The Commission is of the view that a lawyer engages in "unethical or improper professional conduct" under the following circumstances: When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's non-compliance. The Commission has determined that this interpretation will be applicable only to conduct occurring after the date of this opinion.³⁴

This pronouncement is a novel and major departure for an administrative agency. It asserts that the Commission is empowered to determine professional standards for lawyers in a broad range of activities cutting a wide swathe across the entire practice of corporation law. It asserts that the Commission may require the lawyer to end his client's noncompliance with the federal securities laws and demands that the lawyer act promptly in doing so. In short, it co-opts the lawyer into carrying out broad enforcement requirements on the Commission's behalf. The Commission apparently intends to enunciate standards for lawyers' conduct on its own, presumably after first requesting expressions of opinion on the subject from the general public. The Commission does not call upon the organized bar to regulate itself, apparently assuming that any action by the bar would be inadequate. Its reluctance to await the bar's formulation of rules for lawyers in this area is extraordinary, since the bar is already working on this problem and since the proposed Model Rules came close to adopting the theory of the Commission's own complaint in *Carter-Johnson*. It is unfortunate that the Commission is shunting aside so brusquely the process of self-regulation and that it may suspend normal deference to self-regulation by the bar in its haste to establish its own jurisdiction by promulgating regulations on the subject.

The Commission specified that the lawyer is not subject to sanctions merely because his advice is not being followed or even sought. Instead, only when the lawyers learns that his advice will not be followed must he take "further, more affirmative steps in order to avoid the inference that he has been co-opted, willingly or unwillingly, into the scheme of non-disclosure."³⁵ The Commission continued:

The lawyer is in the best position to choose his next step. Resignation is one option, although we recognize that other considerations, including the protection of the client against foreseeable prejudice, must be taken into account in the case of withdrawal. A direct approach to the board of directors or one or more individual directors or officers may be appropriate; or he may choose to try to enlist the aid of other members of the firm's management. What is required, in short, is some prompt action that leads to the conclusion that the lawyer is engaged in efforts to correct the underlying problem, rather than having capitulated to the desires of a strong-willed, but misguided client.

Some have argued that resignation is the only permissible course when a client chooses not to comply with disclosure advice. We do not agree. Premature resignation serves neither the end of an effective lawyer-client relationship nor, in most cases, the effective administration of the securities laws. The lawyer's continued interaction

³⁴ [1981 Current Binder] FED. SEC. L. REP. (CCH) ¶ 82,847 at 84,172.

³⁵ *Id.*

with his client will ordinarily hold the greatest promise of corrective action. So long as a lawyer is acting in good faith and exerting reasonable efforts to prevent violations of the law by his client, his professional obligations have been met. In general, the best result is that which promotes the continued, strong-minded and independent participation by the lawyer.³⁶

In setting forth the circumstances in which corporate counsel may be compelled to report to the board over the head of the CEO, the Commission is attempting to govern the fundamental relationship between lawyer and client corporation—to supervise the manner in which, and the persons through whom, the lawyer may deal with his client. It is important to note that this situation does not involve, even indirectly, the lawyer's actions on the client's behalf before the SEC. Nor does it involve the character of the advice given by the lawyer to his client concerning securities laws or regulations. Instead, it involves the basic question of who acts for the corporation in discussing legal matters with the corporation's lawyer. It is primarily a matter of agency law or corporation law, not securities law. *Carter-Johnson* asserts the widest kind of SEC jurisdiction over lawyers and the broadest kind of right to intervene in the attorney-client relationship, and it should arouse concern and reaction from the bar. Whether the Commission's decision turns out to be a gesture of conciliation to the bar or a booby-trap—as two knowledgeable commentators have antithetically categorized it³⁷—it is surely a bootstrapping by the SEC of its power to regulate the bar and to deal with office practice at the core of the attorney-client relationship.

V. An Alternative Approach

Rather than follow either the provisions of Model Rule 1.13 or the reporting process suggested by the SEC, a corporation might well prefer to establish an intra-corporate procedure under which the corporation's lawyer would appear regularly before the board, or before a litigation or audit committee of the board, to inform it of the company's current legal situation. Under this procedure, the board would make manifest its expectation that the lawyer discuss with the board or its committee the full spectrum of the corporation's legal affairs. The CEO would thus expect the lawyer routinely to bring to the board's attention any legal advice he had given to the corporation's officers, and both the CEO and the lawyer would know that it was incumbent upon the lawyer to take such action. This kind of structural arrangement would change the whole atmosphere of the manner in which the board was kept apprised of legal developments within the corporation and would help clarify the lawyer-corporate client relationship. Thus, board members would be required to interrogate the lawyer about the corporation's legal situation and about the nature of legal matters he was discussing with the CEO, even if the lawyer did not bring the matter before the board of his own volition; both the lawyer and the CEO would thoroughly understand in advance that all legal matters which were not *de minimis* would be brought to the board's attention as a matter of routine procedure. Because all parties involved—the board, the officers and the lawyer—would know that this disclosure

³⁶ *Id.*

³⁷ Compare Bialkin, *SEC Clears Air Concerning Lawyers' Disclosure Duties*, N.Y.L.J., Mar. 17, 1981, with Klein, *SEC Hands Securities Bar "Candy-Coated Bitter Pill,"* Legal Times of Wash., Mar. 9, 1981.

process would take place, their conduct and the countercheck system within the corporate structure would both be significantly improved.

Although creating an institutional reporting relationship between the corporation's lawyer and its board would eliminate a number of difficulties inherent in the lawyer-corporate client relationship, there are bound to be problems not disposed of through such a device. It will consequently be necessary to develop supplemental methods for handling these problem situations.

VI. Model Rule 1.13: A Further Critique

The initial draft of Model Rule 1.13 was very close in its effect to the SEC's initial position in its complaint in *Carter-Johnson*. The current version of the rule gives the lawyer greater discretion; it more nearly resembles (although it is stricter than) the Commission's comments in *Carter-Johnson*. The current version requires the lawyer, upon discovering a violation of the law or of a legal obligation owed to the corporation, to use reasonable efforts to prevent injury to the corporation. It then specifies that appropriate measures may include referring the matter to the "highest authority within the organization."³⁸ If that authority insists upon action, or a refusal to act, that is clearly a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, from which substantial injury to the organization is likely to result, the lawyer *may* take such further remedial action as he reasonably believes to be in the best interest of the organization.³⁹ Thus, this part of the rule is couched in permissive rather than mandatory terms. One cannot help but wonder what the SEC's future attitude will be with respect to similar matters if the Model Rules are adopted in their present form. Would the Commission consider such rules determinative of the lawyer's obligation in such a context, or excessively lax and permissive? Would it regard the ABA's position, whether in the Code or (if adopted) the Model Rules, as merely a factor to be considered in connection with the SEC's administration of its own set of rules? These questions remain unresolved by the *Carter-Johnson* case.

The revised rule 1.13 is much improved over the original draft in clarity and in its grant of greater discretion to the lawyer. Nevertheless, a number of troubling questions remain. For example, subsection (b)(3) of the rule states that the measures which the lawyer should take include referring the matter to the "highest authority" that can act on behalf of the corporation,⁴⁰ without clearly indicating the identity of such highest authority. Furthermore, section (c) places the lawyer in the position of being permitted, but not required, to disclose confidential information if he believes such disclosure is in the corporation's best interests—even if the executive officers of the organization hold a contrary belief—or if he thinks the judgment of the "highest authority" is influenced by personal or financial interests of the members of that authority which are in conflict with the corporation's interests. The comment to the rule states that ordinarily, the organization's highest authority is "the board of directors or similar governing body. However, applicable law may prescribe that under certain conditions high-

38 MODEL RULES, *supra* note 6, at 40 (Model Rule 1.13(b)(3)).

39 *Id.* at 41 (Model Rule 1.13(c)).

40 *Id.* at 40-41.

est authority reposes elsewhere, for example, in the independent directors of a corporation."⁴¹ How independence is determined for this purpose is unclear. Also unclear are the circumstances in which the "highest authority" is the shareholder body and how the lawyer should determine whether to go to the board, the independent directors or the shareholders. The difficulties are especially acute when, for example, the board consists of a dozen inside directors and one independent director. On this theory, the latter may constitute by himself the "highest authority."

Model Rule 1.13 and its commentary not only give inadequate guidance in determining lawyers' duties and obligations, but also raise questions concerning the relation of rule 1.13 to the Kutak commission's earlier rules of confidentiality. The rule should provide greater guidance in resolving the lawyer's responsibilities with respect to "the ultimate difficult question" of "whether the lawyer should be required to circumvent the organization's governing body when it persists in a course of action that is clearly violative of law or a legal obligation to the organization and is likely to result in substantial injury to the organization"⁴² The comment to the rule states that "[o]n behalf of the client the lawyer therefore should take the measures that reasonably appear best calculated to protect the client. That may include resigning, informing the members or shareholders, or informing appropriate public authority."⁴³ This seems to suggest that the body of shareholders is not includable as the "highest authority," although the comment is far from conclusive on that point. Permitting the lawyer to act as the ultimate authority in determining whether confidentiality should be breached and what the best interest of the corporation may be, even to the extent of informing the public authorities, seems somewhat arrogant on the part of the bar toward the corporate client and may press toward undue breach of confidentiality. If the lawyer may in some circumstances conclude that the shareholders constitute the corporation's highest authority, other difficulties may be faced in applying section (c) of the rule, which deals with acting to further personal or financial interests of the members of the authority. For example, can the lawyer disclose confidences if the majority shareholder votes his stock at the shareholders' meeting in a way which the lawyer interprets as advancing the shareholder's personal financial interest?⁴⁴

The present Code of Professional Responsibility, in EC 5-18, tells the corporate lawyer little beyond that he is to represent solely the corporation and not interests adverse to the corporation. The Model Rules take a different cut at the problem, dealing with the subject from the primary viewpoint of the lawyer's obligation to protect the corporation against injury from its own officers and directors. Neither the Code nor the Model Rules make any attempt to deal with a vast range of problems which concern thoughtful corporate lawyers and which arise frequently in the course of corporate representation, such as the lawyer's proper role where various parties are contending for control of the corporation,

41 *Id.* at 42-43 (comment to Model Rule 1.13).

42 *Id.* at 43.

43 *Id.*

44 It is interesting and desirable to see that Model Rule 1.13(e) provides for the giving of a *Miranda*-type warning in either a civil or criminal context when dealing with officers or directors who may be in a conflict relationship to the company.

where profit or risk from corporate activities is reallocated, where the interests of various classes of security holders diverge, or during a proxy fight or tender offer.

In all these situations, the dispute is intracorporate and internal; one cannot say with certainty that the corporation is interested or even involved. Although the change under consideration might benefit or harm the corporate entity, in all probability that entity will not be affected. For example, whether preferred stockholders receive six percent or seven percent, and the common stockholders' allocation correspondingly rises or falls, will probably not demonstrably harm or impose liability on the corporation within the Model Rules concept or generate interests adverse to the corporation within the Code concept. A sufficiently sophisticated approach to realities should be undertaken to help delineate the lawyer's proper role in such situations. Perhaps the Model Rules may be modified in this regard before they are finally adopted.

VII. Conclusion

In the light of the current Code of Professional Responsibility, proposed Model Rule 1.13 and the SEC's *Carter-Johnson* decision, it may be useful to venture some tentative responses to those questions set forth at the beginning of this inquiry which have not already been dealt with.

(1) At present, a lawyer's professional relationship with individual clients is fundamentally the same as that with corporate clients, except that individual clients deal directly with the lawyer while corporate clients deal with the lawyer solely through their representatives. This representative phenomenon alters the lawyer-client relationship to the extent that the relationship between the corporation and its representatives may precipitate questions regarding conflict of interest and legitimacy of authority, as well as questions growing out of the multiplicity of persons involved in the usual corporate situation.

(2) Insofar as the interests of officers, directors and discrete shareholder groups differ, the corporate lawyer may be held to owe obligations of disclosure and protection to certain of those persons where their interests do not conflict with the corporation's. In that sense the lawyer for the corporation may have some duties to (and certainly should be attentive to) constituent segments of the corporation.⁴⁵

(3) Section (d) of Model Rule 1.13 purports to set forth some situations where mutual representation of the corporation and certain of its constituent elements is permitted. The section seems to be an accurate summary of current law.

(4) The law is scanty on the question of who hires counsel on behalf of the corporation, although the general practice is that the CEO hires such counsel. Whether any other executives have the right to hire counsel for the corporation might depend upon their area of authority and responsibility and the nature of the legal matter in question. If, however, the corporate by-laws address the question of engaging counsel, such hiring must of course conform with the by-laws. Some boards, as a matter of practice and without any by-law requirement, annually select general counsel for the corporation by board resolution, usually at the

⁴⁵ Similarly, a lawyer representing a partnership might also have to be sensitive to certain situations involving the different persons who make up the partnership.

same time that they pass a similar resolution selecting independent certified public accountants for the corporation. If a corporation engages the general counsel in this manner, the question arises whether counsel so selected owes any greater obligation to the board than counsel selected by the CEO. It does not seem that the object of the counsel's loyalty should depend upon which corporate representative actually selects counsel. Whether selected by the board of directors or by the CEO, counsel represents the corporation and is subject to direction from its highest authority, which ordinarily is the board of directors rather than the CEO.

(5) The person to whom counsel for the corporation should report and who has the right to read counsel's opinions and work product ordinarily depends upon the nature of the relationship discussed above. For example, the board of directors undoubtedly has the right to call upon counsel for disclosure of counsel's activities, reports and opinions. Probably the CEO also has the right to see such reports and opinions, although it is uncertain whether the board could set counsel a legal task and direct counsel to render counsel's legal opinion solely to the board and to withhold it from the CEO (who may or may not be a board member, although he usually would be). The board would be inclined to do this only in an extraordinary situation. The usual situation finds the CEO—the executive in charge of referring legal tasks to general counsel—conferring with general counsel and only later reporting counsel's views to the board of directors. Whether other executives and indeed whether shareholders have similar rights either to assign legal tasks or to examine counsel's opinion raises the whole question of confidentiality, as discussed in *Garner v. Wolfinbarger*⁴⁶ and *Upjohn Co. v. United States*⁴⁷ and their progeny and antecedents.⁴⁸

Since the duties of counsel for a corporation are often uncertain and since the board of directors and counsel may well wish to have a better understanding of the relationship between them, it would probably be beneficial for a corporation to have such relationship described in writing in detail so as to avert misunderstandings. This would be especially valuable if a procedure were set up for periodic communication between counsel and the board of directors or between counsel and a committee designated for that purpose by the board.

The responses offered above do not purport to comprehensively answer the questions set forth at the beginning of this article. But they may help initiate consideration of the optimal manner of responding to those questions, and thereby help resolve some of the uncertainties now surrounding the role of counsel for the corporation.

46 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

47 101 S. Ct. 677 (1981).

48 So much has been written about this subject that it would be inappropriate to address it in the short compass here. See generally Note, *Applicability of Attorney-Client Privilege to Corporate Communications*, 48 U. CIN. L. REV. 819 (1979); Maurer, *Privileged Communications and the Corporate Counsel*, 28 ALA. L. REV. 352 (1967); Brown & Hyman, *The Scope of the Attorney-Client Privilege in Corporate Decision Making*, 26 BUS. LAW. 1145 (1975).